

Welcome to ASA



American Society of Appraisers
www.appraisers.org

Performing Valuations for Financial Reporting Purposes

The Appraisal Process



American Society of Appraisers
www.appraisers.org

INTRODUCTION

Douglas R. Krieser, ASA, FRICS, is the President and founder of Valcon Partners Ltd., a valuation and consulting firm based in Crystal Lake, Illinois. Mr. Krieser's background includes more than 20 years of valuing tangible assets for a variety of purposes including allocation of purchase price, insurance, financing, and tax appeal, among others.

He is a member and current treasurer of the Machinery and Technical Specialties Committee, the former Editor of the M&TS Journal, and is also an instructor for ME201 through ME203.

Mr. Krieser has written several articles and has spoken on a national basis on topics such as the effects of FASB 141 and FASB 142 on the valuation profession, a variety of personal property tax issues, and insurance issues.



American Society of Appraisers
www.appraisers.org

INTRODUCTION

In addition, he is a contributing editor to the latest edition of Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery and Technical Assets (Second Edition) published by the American Society of Appraisers in 2005.

In addition to his ASA membership, Mr. Krieser is also a member of The Royal Institution of Chartered Surveyors (RICS) and holds a B.S. degree in Industrial Engineering from Marquette University.

E-mail: douak@valconpartners.com
Phone: 815-477-1000
Address: 371 East Prairie Street
Suite B
Crystal Lake, IL 60014



WHAT WILL WE ACCOMPLISH?

- Review the Valuation Process
- Point out potential issues when utilizing fixed asset records and discuss potential solutions
- Discuss reporting issues when performing valuations under standards:
 - SFAS 141R (ASC 805 – Business Combinations)
 - SFAS 142 (ASC 350 – Intangible – Goodwill and Other)
 - SFAS 144 (ASC 360 – Property, Plant, and Equipment)
 - SFAS 157 (ASC 820 – Fair Value Measurement and Disclosure)



THE APPRAISAL PROCESS

- The Appraisal Process (for any valuation) has several stages:
 - Pre-Visit Stage
 - Inspection Stage (for many valuations)
 - Analysis/Post-Inspection Stage
 - Reporting Stage
 - Audit Review Stage (for Financial Reporting Valuations) (NOTE: this will not be covered due to time constraints – covered in ME215)



PRE-VISIT STAGE

- The M&TS appraiser must address the following at a minimum:
 - How many and which sites need to be visited?
 - What is the inspection threshold (in terms of Historic Cost, Replacement Cost New , etc)? In many cases, the threshold may correspond to the acquiree's capitalization level (the level at which an item gets added to the fixed asset records as opposed to being expensed).
 - How accurate are the fixed asset records (where should attention be focused)?



PRE-VISIT STAGE

- The M&TS appraiser must address the following at a minimum:
 - What steps will be taken to verify the accuracy and completeness of the fixed asset records?
 - How many days will be dedicated to inspections and analysis in order to produce credible results?
 - What is the Project Timing?



PRE-VISIT STAGE

- The M&TS appraiser must address the following at a minimum:
 - How are major assets found in the field inspections that are not on the asset listing to be handled (if applicable)?
 - How are "ghost assets" to be handled (if applicable)?
 - What approach(es) to value will be utilized?
 - How will you reconcile and report the value conclusions?



PRE-VISIT STAGE

- If you have any questions on the scope of the project (i.e. what is being valued, how many locations are to be visited, etc.)

**Check with the audit team
and the person who
will be reviewing your work!**



PRE-VISIT STAGE

**Proper project arrangements and
pre-inspection preparation will
significantly reduce the number of issues
that might arise during the valuation
process and will allow the appraiser to
gather some helpful information as well
as prepare the client.**



PRE-VISIT STAGE

**Part of this is a thorough review of the
fixed asset records**



PRE-VISIT STAGE

- Questions to ask on the fixed asset records:
 - Is the "run date" of the asset records concurrent with the Valuation Date?
 - Does the asset list contain department or asset tag numbers that might assist in identifying those assets in the field?



PRE-VISIT STAGE

- Questions to ask on the fixed asset records:
 - Is the asset list for one location or several locations and, if it is for several locations, is there a way to segregate the data into the various locations?
 - Are there data fields such as manufacturer, model and serial number that might be hidden or truncated?



PRE-VISIT STAGE

- When deciding which assets to inspect, consider the following:
 - The assets chosen should cover the major assets at the facility;
 - The assets chosen should allow the appraiser to identify those "major" assets which have been retired or otherwise disposed (and assets that will be disposed in the near future);



PRE-VISIT STAGE

- When deciding which assets to inspect, consider the following:
 - The assets chosen should allow the appraiser to identify major idle and salvaged assets (and assets that will be idled or salvaged in the near future);
 - The assets chosen should include those assets which have allocated or costs other than historical cost and for which historic information could not be gathered (regardless of original cost); and



PRE-VISIT STAGE

- When deciding which assets to inspect, consider the following:
 - The assets chosen should include those assets which have been purchased used (regardless of original cost).

NOTE: In choosing which assets to verify and inspect, the appraiser is not necessarily performing a statistical sampling, but rather, is choosing a sample of assets that will produce, in the judgment of the M&TS appraiser, a credible result a outlined under the Scope of Work Rule in USPAP.



PRE-VISIT STAGE

When using a technique as indicated in the previous slides, the M&TS appraiser is not inspecting all of the assets.

The appraiser must make specific assumptions regarding the assets that are not inspected (e.g. existence, condition, etc.).

These assumptions should be duly noted in the appraiser's work papers and in the report as required by USPAP.



WORKING WITH FIXED ASSET RECORDS

As it applies to Tangible Assets, under SFAS 141R (ASC 805), SFAS 142 (ASC 350), SFAS 144 (ASC 360), and SFAS 157 (ASC 820):

- The acquirer's ultimate goal is to have an updated fixed asset record that reflects the Fair Values of the assets as of the acquisition date.
- **Beginning with the fixed asset records as the basis for the valuation has its limitations and appropriate due diligence must be performed in order to perform an accurate and credible valuation.**



WORKING WITH FIXED ASSET RECORDS

When performing a valuation using a fixed asset record as the basis, which set of books do you want to start with (tax books or financial books) and why?



WORKING WITH FIXED ASSET RECORDS

Fixed asset records may include some or all of the following issues:

- Partial or installment payments;
- Allocated values (or values other than historic cost);
- Allocated dates (or dates other than the date that the asset was originally put into service for the first time);
- Assets purchased used;
- "Ghost assets" (i.e., assets that are no longer on site);
- Descriptions that are not easily identifiable or that are not complete;
- Asset entries which actually represent groups of assets;
- Misclassified assets (i.e. machinery or computers in the furniture category; equipment in the building category, etc.);
- Entries that are actually repairs, rebuilds, or additions to existing assets; and/or
- Other concerns or issues.



WORKING WITH FIXED ASSET RECORDS

It is important that the MTS appraiser review the fixed asset records with the appropriate personnel in order to gain an understanding of the various entries.

The MTS appraiser also needs to assess the validity and usefulness of the fixed asset records prior to using them as the basis for the valuation.



DEFINITIONS TO REVIEW

Terms to Remember:

Accrued depreciation: The loss of value from all causes, including physical deterioration, functional and economic obsolescence.

Accumulated depreciation: An accounting term that represents the total depreciation taken against the cost of an asset as of a given date.

Book value: The capitalized cost of an asset less the depreciation taken for financial reporting. (note: *may hear this referred to as "carrying value"*)



DEFINITIONS TO REVIEW

Depreciation (accounting): A mathematical procedure for recovering the original cost of an asset in consistent installments over a specific period.

Depreciation (appraisal): The actual loss in value of a property from all causes, including those resulting from physical deterioration, functional obsolescence and economic obsolescence.



DEFINITIONS TO REVIEW

Historical cost: The cost of a property when it was first placed into service by its first owner.

Original cost: The initial capitalized cost of the asset in the hands of its present owner.

Accounts: Major groupings of assets that are similar in character.

Classifications: A more finite breakdown of accounts.



USING FIXED ASSET RECORDS AS A BASIS FOR THE VALUATION

It is critical to know the run date of the fixed asset record.

If the asset record is not concurrent with the valuation date, adjustments will have to be made in order to properly reflect the listing of owned assets as of the valuation date.



USING FIXED ASSET RECORDS AS A BASIS FOR THE VALUATION

Additional questions to consider while analyzing the asset record are:

1. Does the asset list contain department or asset tag numbers that might assist in identifying those assets in the field?
2. Is the asset list for one location or several locations and, if it is for several locations, is there a way to segregate the data into the various locations?
3. Are there data fields such as manufacturer, model and serial number that might be hidden or truncated?
4. Do we have enough information in order to report the values in a way that is meaningful for the client?



ISSUES THAT NEED TO BE ADDRESSED

Are "direct" or "non-direct" costs included in the entries?

Direct Costs are costs directly applicable to individual assets:

- Freight
- Rigging and moving
- Electrical
- Foundations
- Piping
- Millwrighting
- Labor for erection
- Sales tax (if applicable)



ISSUES THAT NEED TO BE ADDRESSED

Indirect Costs, or costs typically spread throughout an entire construction project:

- Temporary insurance
- Engineering
- Licenses, permits, fees
- Overtime
- Security
- Typical finance charges during construction



ISSUES THAT NEED TO BE ADDRESSED

How do you handle these entries?

- Understand what the asset line items represent.
- Perform due diligence in your field inspections.
- Hold discussions/interviews with company personnel.
- Etc.



ISSUES THAT NEED TO BE ADDRESSED

Partial or installment payments

How do you handle these entries?

- Understand what the asset line items represent.
- Work with plant personnel (accounting and manufacturing) to identify key line items and how they relate to the assets that are actually on the floor.
- Potentially combine all of the line items into one line item for valuation purposes.



ISSUES THAT NEED TO BE ADDRESSED

Allocated values (or values other than historic cost) and allocated dates (or dates other than the date that the asset was originally put into service for the first time)

Previous allocations and valuations present particular challenges to the appraiser, especially when the derivation and reliability of the values cannot be tested or otherwise gauged.

Also, another concern is whether or not impairment charges have been taken previously and how these have been accounted for on the asset records.



ISSUES THAT NEED TO BE ADDRESSED

Some of the ways to identify potential asset allocations include:

- Many assets have the same in service date;
- All (or many) of the values are rounded, and/or
- Several assets have zero acquisition value.



ISSUES THAT NEED TO BE ADDRESSED

Using allocated values as the basis for the cost approach is not acceptable appraisal methodology and will not produce a credible appraisal.

The appraiser will need to perform additional research and analysis in order to perform a credible appraisal.

This additional research and analysis may change/affect the scope of work required.



ISSUES THAT NEED TO BE ADDRESSED

How do you handle these entries?

Allocated values can be handled by the appraiser using several methods which are listed below in order of preference:

1. Gather electronic historical cost and date information for the allocated assets. In many cases, clients maintain several different sets of data regarding the assets listed in the fixed asset records. They may have maintained historical cost and purchase date data in their tax books or other asset files.
2. Gather a hard of the copy historical cost and date information for the allocated assets. If the allocation is recent and if the electronic data is no longer available, the client may have retained hard copies of the data.



ISSUES THAT NEED TO BE ADDRESSED

How do you handle these entries?

3. Perform market research on all of the allocated assets. *This is the most reliable method but it may be time consuming if there are many allocated assets.*
4. Perform Replacement Cost New research on all of the allocated assets. Once reliable Replacement Cost New values are obtained, the MTS appraiser should perform a valid cost approach.

This is a very reliable method, but, again can be very time consuming if there are many allocated assets.



ISSUES THAT NEED TO BE ADDRESSED

How do you handle these entries?

- 5. Segregate and handle the assets from the allocated years using a method similar to the Remaining (Aggregate) Obsolescence Factor process or some other logical and supportable methodology.

NOTE: This process is reviewed in ME215



ISSUES THAT NEED TO BE ADDRESSED

Assets purchased used

Why is this an issue?

How do you handle these entries?

You can use some of the same processes as indicated for Allocated Values.



ISSUES THAT NEED TO BE ADDRESSED

"Ghost assets" (i.e., assets that are no longer on site)

How can this occur?

How do you handle these entries?

- Perform due diligence in your field inspections.
- Hold discussions/interviews with company personnel.
- Etc.



ISSUES THAT NEED TO BE ADDRESSED

Descriptions that are not easily identifiable or that are not complete

How can this occur?

How do you handle these entries?

- Perform due diligence in your field inspections.
- Hold discussions/interviews with company personnel.
- Etc.



ISSUES THAT NEED TO BE ADDRESSED

Asset entries that actually represent groups of assets

How can this occur?

How do you handle these entries?

- Perform due diligence in your field inspections.
- Hold discussions/interviews with company personnel.
- Etc.



ISSUES THAT NEED TO BE ADDRESSED

Misclassified assets (i.e., machinery or computers in the furniture category; equipment in the building category, etc.)

How can this occur?

How do you handle these entries?

In handling these line items, you need to make sure that you classify the assets properly for valuation purposes (especially if you are using a valuation model).



ISSUES THAT NEED TO BE ADDRESSED

Caveat: NEVER change the accounts or classifications assigned by the clients; ALWAYS report values in the same accounts/ classifications as provided by the client for traceability and consistency.



ISSUES THAT NEED TO BE ADDRESSED

Entries that are actually repairs, rebuilds, or additions to existing assets

How can this occur?



ISSUES THAT NEED TO BE ADDRESSED

How do you handle these entries?

There are differing opinions on how to handle these.

Some MTS appraisers value them since it is their opinion that in failing to do so, they may be undervaluing the assets.

Some MTS appraisers remove them from the analysis under the theory that they "value" them as part of the equipment to which they apply.



ISSUES THAT NEED TO BE ADDRESSED

Assets not listed on the asset records

How can this occur?

How do you handle these (lack of) entries?

The answer to this issue really depends on the Materiality of the line items not being listed. It is the job for the appraiser to provide "credible" results. As such, the approach taken and the efforts expended depends on the "Scope of Work" that the appraiser concludes will produce credible results.



ISSUES THAT NEED TO BE ADDRESSED

Conclusion

Based on the intended use of the appraisal, it often (but not always) makes sense to use the acquiree's fixed asset records as the basis of the appraisal.

However, this presents some challenges which have to be addresses by the appraiser when developing their "Scope of Work" so that they provide credible results.



FIELD INSPECTION STAGE

■ During the field inspection stage, the appraiser should:

- Gather appropriate data on the sampled assets as discussed in the M&TS POV courses and in the most current M&TS textbook (Classification and Description of Machinery and Equipment) and as taught in the various ASA courses
- Gather information on rebuilds, upgrades etc. including how to tie these entries into specific assets (as practical)
- Gather the appropriate data required to perform the Cost Approach, Sales Comparison Approach and the Income Approach (as applicable)



FIELD INSPECTION STAGE

- During the field inspection stage, the appraiser should:
 - Gather data on assets which are grouped or lumped on the fixed asset records
 - Gather data on any assets which may have been disposed
 - Identify assets which are idled, cannibalized, scheduled for disposal, etc.
 - Gather data on any differences in the asset record (or the assets inspected) between the Valuation Date and the date of the inspection (as applicable)



FIELD INSPECTION STAGE

- During the field inspection stage, the appraiser should:
 - Discuss disposition policies with accounting and production personnel separately. Asking the same question of different people may result in different answers and may lead to be further investigation
 - Gather all other data the appraiser deems necessary to perform a credible appraisal.



POST INSPECTION STAGE

- During this stage, the appraiser should:
 - Perform Cost, Sales Comparison, and Income Data Research (as applicable and appropriate)
 - Perform the Cost, Sales Comparison, and Income Approaches for the assets (as applicable and appropriate)
 - Calculate any applicable obsolescence factors (as appropriate)
 - Prepare the final report and exhibits for the client.



APPROACHES UTILIZED IN FINANCIAL REPORTING VALUATIONS

The appraiser should consider all of the approaches to value.

The appraiser should use those approaches for which here is sufficient data.

Typically, for the MTS appraiser, this means utilizing the Cost Approach and/or the Sales Comparison/Market Approach.

In most cases, valuation performed for financial reporting purposes will use a combination of both the Cost Approach and the Sales Comparison/Market Approach.



HELPFUL TOOLS TO UTILIZE

Useful tools introduced in ME201 to ME204, ME207 and ME215:

- Trending (Reproduction Cost New)
- Cost to Capacity (Reproduction or Replacement Cost New)
- Inutility Calculations (Functional or Economic Obs)
- Remaining (or Aggregate) Obsolescence (Economic Obs)
- Effective Age/Weighted Age Calculations (Physical Deterioration)
- Excess Operating Costs (Functional or Economic Obs)
- Business Enterprise Valuation (BEV) (Economic Obs)
- Percent to Cost (Market Derived Depreciation Curves)



REPORTING STAGE

■ During this stage, the appraiser should:

- Provide the client (and auditor) a report that meets the applicable financial reporting standards (i.e. ASC 805, ASC 820, ASC 350, or ASC 360) and USPAP
- Provide (at least on an aggregate basis) a comparison of:
 - Historic Cost
 - Net Book Value
 - Fair Value
- Provide an indication of Remaining Useful Life ("RUL")



REPORTING STAGE

- During this stage, the appraiser should:
 - Potentially provide an electronic copy of the asset records (including all data fields originally provided and indications of Fair Value) so client can load the data into their fixed asset system
 - Provide other data gathered in the field that may be valuable for the client (i.e. manufacturer, model number, serial number of the assets inventoried (as applicable)
 - Prepare for the audit process




